Journal of Accountancy

Volume 49 | Issue 6 Article 4

6-1930

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There may exist among accountants a disagreement as to the pleasures one derives from the practice of our profession, but never is there that disagreement when the question of enjoying the study of accountancy arises, with its many intricate and interesting problems: some highly theoretical yet extremely fascinating; many always practical. The study of accountancy touches many phases of industrial and economic life and in its many manifestations we find that accountancy and the law become interrelated. And, because of this interrelation it seems desirable that the accountant become better acquainted with the law and appreciate its effect on and significance to accounting. In an attempt to dissect the law the writer has taken one phase, namely partnership law, and correlated it to accountancy.

In discussing the relationship of partnership law to accounting it is advisable that a comprehensive definition of partnership be available. Such a definition should establish the cardinal principles of a partnership, and from that as the starting point we can evolve the theoretical and practical principles of accounting. Some legal lexicographers define partnership as a voluntary contract between two or more competent persons to place their money, effects, labor and skill, or some or all of them, in lawful commerce or business, with the understanding that there shall be a proportional sharing of the profits and losses between them (See Black's *Law Dictionary*). It is not necessary, at this point, to elucidate this definition; its various aspects are dealt with at greater length hereafter.

The accountant is at times in conference with lawyers and is expected to understand some of the legal terminology so far as it involves accounting practice. It is therefore necessary for us to familiarize ourselves with the various types of existing partnerships. The law has separately stated and defined these partnerships.

A general partnership is one in which the partners carry on all their trade and business, whatever it may be, for the joint benefit and profit of all the parties concerned, whether the capital stock be limited or not, or contributions thereto be equal or unequal.

A limited partnership consists of one or more general partners, jointly and severally responsible as ordinary partners, by whom the business is conducted, and one or more special partners, contributing in cash payments a specific sum as capital to the common stock, who are not liable for the debts of the partnership beyond the funds so contributed.

A particular partnership is one existing where the parties have united to share the benefits of a single individual transaction or enterprise.

A partnership at will is one designed to continue for no fixed period of time, but only during the pleasure of the parties, and it may be dissolved by any partner without previous notice.

The law also deals with various kinds of partners. We have what is commonly called dormant partners, those whose names are not known or do not appear as partners. Dormant partners are really those who are merely passive in the firm whether known or unknown, in contradistinction to those who are active and conduct the business of the firm as principals. The terms silent partner and sleeping partner are popular names for dormant partner.

A nominal partner is one whose name appears as a member of the firm, but who has no real interest in it.

A liquidating partner is the one who, upon dissolution or insolvency of the firm, is appointed to settle accounts, collect assets, adjust claims and pay debts.

A surviving partner is one who, on the dissolution of the firm by death of his copartner, occupies the position of a trustee to settle up its affairs.

Death of a partner terminates a partnership. At the death of a partner the books should first be closed and the profit or loss from operations determined. Then the deceased partner's capital account should be transferred to an estate account. The loss through liquidation should be recorded separately in an account known as the liquidation account.

The mere fact that persons own property in common, or are sharing gross returns, does not of itself establish a partnership, whether the persons sharing profits have or have not a joint or common right or interest in any property from which the returns are derived. The receipt by a person of a share of the profits of a business is prima-facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment of (a) debt, by instalments or otherwise; (b) wages or rent; (c) an annuity to a representative or widow of a deceased partner; (d) interest on a loan; or (e) consideration for the sale of the goodwill of a business or other property by instalments or otherwise. (Sect. 11, partn. law of N. Y.)

When the owner of a business devises it to his two sons, share and share alike, and the sons continue the business and divide the profits, a partnership is thereby created between them (*MacFarlane* v. *MacFarlane*—1894—82 Hun 238, 31 N. Y. S. 272). In this case, the proper entry would be to divide the capital account equally, debiting the individual's capital account and crediting the capital accounts of the two sons. As an explanation for this entry the clause in the will wherein the devise is mentioned should be cited.

At times the accountant is confronted with a problem wherein separate creditors of a manufacturing concern take over the business in payment of their claims, the business is continued for the purpose of realizing the claims, and there is no partnership among the creditors, the interest of the parties not being joint. We are, however, primarily interested in the entries on the books of the partnership. The entries are basically the same as those discussed in the following paragraphs dealing with assignments for the benefit of creditors.

A general assignment in its ordinary legal significance means an assignment by a debtor, transferring all his property, in general terms, to an assignee, in trust for all his creditors (*Young* v. *Stone*, 70 N. Y. S. 558—Aff'm'd 174 N. Y. 517). Its material and essential characteristic is the presence of a trust. The assignee is merely trustee and not absolute owner (*Brown* v. *Guthrie*, 110 N. Y. 435).

One or more members of a firm can not execute a general assignment for the benefit of creditors without the consent of the other member or members of the firm; but, if it appears from the acts or declarations of such member or members, either before or subsequent to the assignment, that he or they assented to its execution, the assignment is valid.

When an assignment is made for the benefit of creditors, the entries on the books of the assignor should be as follows: (Assume that the assets are worth $1,500, liabilities $2,000, A's capital $250 (dr.), and B's capital $250—(dr.).) The first entry is to debit the "trustee" $1,500 and credit the assets $1,500.

Then, when the trustee makes his accounting showing that he has paid the creditors, say 50 cents on the dollar, the next entry is to debit liabilities $2,000, credit "trustee" $1,000 and credit a capital account "allowance on settlements with creditors" $1,000. If the trustee accounts for the balance as expenses, one must debit "expense" $500, and credit "trustee" $500. This would close the "trustee" account.

The accounts would appear as follows:

Assets

1,500—	(1) 1,500—
1,500—	1,500—

Liabilities

(2) 2,000—	2,000—
2,000—	2,000—

Expense

(3) 500—	Closed to	
	Capital	500—
500—		500—

A Capital

	250—	Allow etc.	500—
Exp.	250—		
	500		500

B Capital

	250—	Allow etc.	500—
Exp.	250—		
	500		500

Trustee

(1)	1,500—	1,000—	(2)
		500—	(3)
	1,500—	1,500—	

Allowance on settlements with creditors

Closed to		1,000—	(2)
Capital	1,000—		
	1,000—	1,000—	

Of course, the accounts could be made more elaborate by including numerous temporary capital or nominal accounts, but I have purposely omitted them for purposes of brevity.

It seems necessary, from the accountant's viewpoint, to determine whether property in the possession of the partner is partnership property or not. The law has enumerated some of these instances:

1. All property originally brought into the partnership stock or subsequently acquired, by purchase or otherwise, on account of the partnership, is partnership property.

2. Unless the contrary intention appears, property acquired with partnership funds is partnership property.

3. Any estate in real property may be acquired in the partnership name.

4. A conveyance to a partnership in the partnership name passes the entire estate of the grantor unless a contrary intention appears. (Sect. 12 partn. law of N. Y.)

In the verification of assets, the accountant or auditor is confronted with the problem of determining the right of one partner to obligate the partnership. Under section 20 New York partnership law we find the following:

1. Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member, binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.
2. An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.
3. Unless authorized by the other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to—
   (a) Assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership.
   (b) Dispose of the goodwill of the business.
   (c) Do any other act which would make it impossible to carry on the ordinary business of the partnership.
   (d) Confess judgment.
   (e) Submit a partnership claim or liability to arbitration or reference.
4. No act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.

The principle of agency applies to copartners, but it is only when it can be seen that a partner is in effect acting as an agent of his copartners that he binds them (*Brenenstak* v. *Ammidown*, 1898, 155 N. Y. 47).

Where there is no general partnership but only a partnership as to a particular transaction, the power of a partner to bind his copartner extends only to acts necessarily connected with the subject of the transaction (*Macaulay* v. *Palmer*, 126 N. Y. 742).

Limitations in the partnership articles on the powers of the partners are not binding on third persons having no notice of them. Nor does the fact that a partnership agreement gives one partner power to do certain branches of the partnership business restrict the exercise of similar powers by the other partners in the absence of restrictive words.

But, although a partner may ordinarily borrow money on the firm note, he may not do so where the purposes for which the money is borrowed are not within the scope of the partnership business, or the partnership is not such a one as calls for the borrowing of money (*Williams* v. *Wupperman*, 171 app. div. 592). Thus he can not charge the firm for a loan made to him individually and for his own purposes (*Porter* v. *Lobach* 2 Bos. 88). Likewise he can not borrow money on his individual note and bind the firm to repay the money by a mere representation that he is borrowing the money for the firm (*Thorn* v. *Smith*, 21 Wend. 365).

One partner may execute the firm note to another partner in payment of a firm debt to the partner (*Smith* v. *Lushr*, 5 Con. 688).

One partner may sell, pledge, mortgage or otherwise dispose of any of the copartnership property or assets for the purpose of securing a firm debt.

An accountant should examine deeds or contracts of sale of real estate to ascertain whether the partner had authority to execute them or not. If the partner had no right to execute them the property should still be considered as property of the partnership and the consideration received therefor should be considered as trust money held by the partnership on behalf of or for the benefit of the vendee of the property.

Where the title to real property is in the partnership name, any partner may convey title to such property by a conveyance executed in the partnership name; but, the partnership may recover such property unless the partner's act binds the partnership.

The rights and duties of partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

1. Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property and share equally in the profit and surplus remaining after all liabilities including those to the partners are satisfied; and must contribute toward the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.

2. The partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property.
3. A partner, who in aid of the partnership makes any payment or advance beyond the amount of capital which he agreed to contribute, shall be paid interest from the date of the payment or advance.
4. A partner shall receive interest on the capital contributed by him only from the date when repayment should be made.
5. All partners have equal rights in the management and conduct of the partnership business.
6. No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.
7. No person can become a member of a partnership without the consent of all the partners.
8. Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but, no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners.

The accountant, when informed by a client that he intends to go into partnership, should request that a copy of the articles of copartnership be given to him for his files. If that agreement is not given him he should abstract from articles of copartnership the following information, and more if possible, and embody it in his work sheets.

1. Date of formation of copartnership and its duration.
2. Names of all partners and addresses.
3. Name of firm and location of its business.
4. Investments.
5. Sharing of profits and losses.
6. Drawings.
7. How books are to be kept and when accounting is to be made.
8. Manner of dissolution.

In case the copartnership is formed by oral agreement, the accountant should ascertain these things, and, also, remember that the law provides that profit and losses are shared equally, that a copartner can not claim a salary for services rendered, that interest on investment can not be allowed and that, on dissolution, net assets are shared equally. Where, however, salary allowances are made, they should be treated as a distribution of the profits to the partner and not as an expense. For bookkeeping purposes, salaries are often classified as expenses in order to show the profit the business would return if it were necessary to hire an outsider to perform the work done by the partner.

As salary may be considered a special distribution of profit, so an allowance of interest on capital invested provides a means of compensating the partner having the larger capital. Interest of this kind is not, therefore, an expense of the business, but serves as a capital investment. A more scientific method would be to determine the average investment during the year, which would take into consideration drawing by partners. To illustrate:

A and B are partners—A's capital is $15,000. B's capital is $10,000. Profit is $2,500. Interest is to be allowed at 6%. The entries are:

Profit and loss	$1,500.00	
A's capital		$900.00
B's capital		600.00
Crediting each partner with interest on his investment.		
Profit and loss	$1,000.00	
A's capital		$500.00
B's capital		500.00
Distributing profit equally after deducting interest charge.		

It has been held that a partnership has an insurable interest in the life of a partner, and many partnerships have taken out insurance on the life of partners in order to protect themselves from financial loss in case of death of the partner so insured. It should be noted, therefore, that the cash-surrender value of a policy, when a cash-surrender value comes into existence, should be treated as an asset. When the premium payments are made the entire payment can be charged to insurance expense, but at the end of the year an adjustment should be made for the cash-surrender value. In case of death, the asset account which contains the cash-surrender value of the policy is credited with the cash received from the insurance company and the excess is divided equally between the surviving partner and the deceased partner's estate on a profit-and-loss ratio.

Sometimes the articles of copartnership determine when the partnership shall terminate, but partnerships may be unexpectedly terminated by death, insanity, etc., of a partner, by withdrawal of one partner and by admission of a new partner, and by mutual agreement of the partners to sell or liquidate their business. Where the articles of copartnership determine the procedure to be used that procedure of course must be followed.

Dissolution of a partnership is a change in the relation of the partners caused by any partner's ceasing to be associated in carrying on as distinguished from the winding up of the business. On dissolution the partnership is not terminated but continues until the winding up of partnership affairs is completed. Dissolution is caused:

1. Without violation of the agreement between the partners.
   - (a) By the termination of the definite term or particular undertaking specified in the agreement.
   - (b) By express will of any partner when no definite term or particular undertaking is specified.
   - (c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking.
   - (d) By the expulsion of any partner from the business in accordance with such a power conferred by the agreement between the partners.
2. By any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership.
3. By death of any partner.
4. By the bankruptcy of any partner or of the partnership.

It is a general rule that a contract of partnership is dissolved by the death of one of the parties whether entered into for a fixed time or not, and that after his death the former partner can not bind the estate of the deceased by new contracts; and, although the partnership be expressly extended to executors, they can not be compelled to carry it on and will be entitled to a dissolution and an account of assets subject to the liabilities of the firm incurred up to the time of dissolution. (*Stem* v. *Warren*, 1920, 227 N. Y. 538, 125 N. E. 811.)

A partnership continues, notwithstanding a formal dissolution, as to third persons acting in good faith who have had not actual or constructive notice that the firm has been dissolved. The rule is that, to all persons who have had actual dealings with the firm, actual notice of the dissolution must be given (*Zavodnik* v.

Goldberg, 1917, 165 N. Y. S. 526). Where, upon dissolution of a partnership, the continuing partner takes over the assets and assumes the liabilities of the old firm, the relation of the retiring partner is that of surety as to the obligations of the old firm existing at the dissolution.

A conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor, as against the other partners, in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books; but, it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled. (Section 53, sub. 1, partnership law of New York.)

In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

1. The assets of the partnership are:
   (a) Partnership property.
   (b) Contributions of the partners necessary for the payment of all the liabilities.

2. The liabilities of the partnership shall rank in order of payment, as follows:
   (a) Those owing to creditors other than partners.
   (b) Those owing to partners other than for capital and profits.
   (c) Those owing to partners in respect of capital.
   (d) Those owing to partners in respect of profits.

3. The assets shall be applied in the order of their declaration in clause (1) of this paragraph to the satisfaction of the liabilities.

4. The partners shall contribute the amount necessary to satisfy the liabilities; but if any, but not all, of the partners are insolvent, or refuse to contribute, the other partners shall contribute their share of the liabilities and in the relative proportions in which they share the profits the additional amount necessary to pay the liabilities.

5. Any partner or his legal representative shall have the right to enforce the contributions specified in paragraph (4) to the extent of the amount which he has paid in excess of his share of the liability.

6. The individual property of a deceased partner shall be liable for the contributions specified in paragraph (4).

7. When partnership property and the individual properties of the partners are in the possession of a court for distribution,

partnership creditors shall have priority on partnership property and separate creditors on individual property.

8. Where a partner has become bankrupt or his estate is insolvent the claims against his separate property shall rank in the following order:

(a) Those owing to separate creditors
(b) Those owing to partnership creditors
(c) Those owing to partners by way of contribution.

Upon the appointment of a receiver of a partnership the wages of the employees of such partnership shall be preferred to every other debt or claim.

Section 80 of the New York partnership law authorizes partners, continuing the business of a dissolved firm which comes within its terms, to perpetuate the firm name regardless of the consent of a retiring partner whose name forms part of the firm name, where the name was not disposed of in the dissolution (*Caswell* v. *Hazard* 1890, 121 N. Y. 484, 24 N. E. 707). Also see sections 924 and 440, penal law.

A partnership business is sometimes sold to others and the business continued as before except for change of owners. The sale may be made to an individual, another partnership or to a corporation. Changing the form of legal organization from a partnership to a corporation amounts to the same thing as selling the business to a corporation. In all these cases the method of handling the matter on the books of the firm is the same. The books having been closed, the only accounts remaining open in the ledger are those with assets, liabilities and partners' capital. An account is then opened with the buyer of the business, who is known as the vendee, and the books may be closed by following the ensuing instructions:

1. Record on the books the goodwill incidental to the sale of the business by debiting a goodwill account and crediting the partners' accounts in proportion to profit-sharing arrangement.
2. Charge the assets (including goodwill) sold to the vendee by debiting the vendee and crediting the various asset accounts.
3. Credit the vendee for the liabilities assumed by debiting the various liability accounts and crediting the vendee.
4. Credit the vendee for whatever assets are received from him in payment for the net assets of the partnership by debiting the asset or assets received and crediting the vendee.
5. Pay off any obligations not assumed by the vendee.
6. Pay off any partners' loans or salaries.
7. Distribute the assets received from the vendee by debiting the partners' capital accounts and crediting the asset accounts.

Unless otherwise agreed, the distribution will be in the ratio that each partners' capital bears to the total capital at the time of distribution. In other words, each partner should be paid enough to balance his capital account, and that will take all the assets on hand.

Instead of a dissolution brought about by the sale of the business as a going concern, in which there is usually a profit for the partners, due to the goodwill, a firm sometimes undertakes to dispose of its assets, pay off its liabilities and close the business. In this case there is usually a liquidated loss which must be borne by the partners in profit-and-loss ratio. In such cases the books are closed as before, and the trading profit or loss transferred to the current accounts, which in turn are closed into the partners' capital accounts so that only asset, liability and capital accounts appear in the ledger. The assets are then converted into cash as soon as possible and the claims against the assets are paid in the following order: (a) mortgages, (b) preferred outside claims such as wages, taxes, etc., (c) liabilities due outside creditors, (d) loans and salaries due partners, (3) capital accounts of partners.

Any profits or losses resulting from the conversion of the assets into cash are shared by the partners in profit-and-loss ratio. The bookkeeping procedure for closing the accounts is as follows:

1. Debit cash for amount received from the sale of assets, and profit and loss for the loss on liquidation; credit the various assets for the value shown on the books.
2. Debit the partners' capital accounts for the loss on liquidation in profit-and-loss ratio; credit profit-and-loss account.
3. Pay off outside liabilities; debit each liability paid off and credit cash.
4. Pay off salaries and loans of partners, if any; debit proper account and credit cash.
5. Distribute the balance of cash among the partners in capital ratio. This will balance the capital and cash accounts and close all accounts.

Sometimes the loss from liquidation is so large that a partner is rendered insolvent thereby. His capital account is entirely wiped out and leaves him in debt to the firm. His capital account in such a case shows a debit balance which he is obliged to make good by paying into the firm cash to that amount.

The certificate of limited partnership is kept on file and recorded in the office of the county clerk of the county in which the principal office of the partnership is located. The accountant should examine the certificate and extract those clauses which affect his work.

The certificate contains, among other things, the following information:

1. The name and place of residence of each member; general and limited partners being respectively designated.
2. The term for which the partnership is to exist.
3. The amount of cash and a description of and the agreed value of the other property contributed by each limited partner.
4. The additional contributions, if any, agreed to be made by each limited partner and the times at which or events on the happening of which they shall be made.
5. The time, if agreed upon, when the contribution of each limited partner is to be returned.
6. The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution.
7. The right, if given, of one or more of the limited partners, as to contributions or as to compensation by way of income, and the nature of such priority.
8. The right, if given, of the remaining general partner or partners to continue the business on the death, retirement or insanity of a general partner.
9. The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.

A limited partnership may conduct any business which a partnership without limited partners may conduct. The contributions of a limited partner may be cash or other property, but not services. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

Under the former law doubt was expressed on the question whether a general partner, without the consent of his special partner, might make an assignment for the benefit of creditors. (*Mills* v. *Argall*, 1833, 6 Paige, 577.) Subsequently, it was held that general partners might make a general assignment for the benefit of creditors. (*Robinson* v. *McIntosh*, 1854, 3 E. D. Smith 221.)

A limited partner shall have the rights as a general partner to—

(a) Have the partnership books kept at the principal place of business of the partnership and at all times to inspect and copy any of them.

(b) Have on demand, true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable, and

(c) Have dissolution and winding up by decree of court.

A limited partner shall have the right to receive a share of the profits or other compensation by way of income and to the return of his contributions.

A person may be a general partner and a limited partner in the same partnership at the same time. A person who is a general partner, and at the same time a limited partner, shall have all the rights and powers and be subject to all the restrictions of a general partner, except that, in respect to his contributions, he shall have the rights against the other members which he would have had if he were not also a general partner.

A limited partner also may lend money to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors, a pro-rata share of the assets.

On the death of a limited partner his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate. The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

On settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order:

1. Those to creditors, in the order of priority as provided by law, except those to limited partners, on account of their contributions, and general partners.
2. Those to limited partners in respect to their share of the profits and other compensation by way of income on their contributions.
3. Those to limited partners in respect to the capital of their contributions.
4. Those to general partners other than for capital and profits.
5. Those to general partners in respect to profits.
6. Those to general partners in respect to capital.

Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contributions respectively, in proportion to the respective amounts of such claims.